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TaxNewsFlash

Canada

CRA Updates EIFEL Guidance — Are You Affected?

January 23, 2026
No. 2026-07

Corporations and trusts should review the CRA's latest guidance on the Excessive Interest and Financing Expenses Limitation (EIFEL) rules. These rules generally limit the amount of net interest and financing expenses that may be deducted by affected corporations and trusts. Even corporate groups consisting of all Canadian-resident entities should review the CRA's welcome new administrative guidance and ensure that they evaluate every corporation and trust in their group to determine their filing and reporting obligations. In particular, the CRA recently revised its EIFEL guidance to:

- Clarify how to determine interest and financing expenses (IFE) and interest and financing revenue (IFR) in certain situations

- Provide details on how taxpayers must file certain elections

- Address other compliance issues, including late-filing penalties, necessary processes that may result from taxpayer errors and additional instructions for EIFEL SCH130 forms.

Corporations and trusts should determine whether they may be affected and model potential impacts in advance of the 2025 compliance season, including on after-tax cashflows. Affected taxpayers should also reconcile and determine group-wide EIFEL carry over amounts or attributes for all eligible group entities from the first regime year. Your KPMG tax advisor can help support your EIFEL compliance by leveraging KPMG's specialized digital tools and resources, including comprehensive EIFEL calculators and detailed form templates.

Background

The EIFEL rules generally apply to corporations and trusts (with certain look-through rules for partnerships) with more than $1 million of net IFE (net of IFR), for taxation years that began on or after October 1, 2023. These rules generally limit the amount of net IFE that may be deducted by corporations and trusts for Canadian income tax purposes to a fixed ratio of generally 30% of "adjusted taxable income" (ATI), subject to certain exceptions and elections to share capacity among eligible group entities. Exceptions include corporations and trusts that qualify as excluded entities for a given year or that can exclude certain IFE relating to public-private partnership infrastructure projects. There is a special and a more restrictive subset of the rules which apply to financial institutions.

Canada's enactment of these rules aligns with several other countries with similar rules, including the U.S. and the UK, which are generally consistent with the OECD's 2015 recommendations in its BEPS Action 4 report, "Limiting Base Erosion Involving Interest Deductions and Other Financial Payments".

The CRA periodically updates its online EIFEL guidance.

IFE and IFR

Approach to "interest"

The CRA's updated guidance clarifies what amounts are considered as "interest" for the purposes of IFE and IFR. The CRA defines "interest" specifically for purposes of the Act, noting that the amount:

- Must itself be considered interest (i.e., an amount that is required to be paid or payable that accrues over time as compensation for the use of borrowed money calculated on a principal sum), or

- Must be on account of, in lieu of payment of or in satisfaction of an amount that is interest (which requires a right to receive interest).

The CRA states that, on this basis, if a taxpayer's payment includes an embedded financing component that doesn't qualify as interest, this component will not be included in IFE or IFR. However, this financing component might be included under other relevant economic equivalent rules in the EIFEL regime.

The CRA's revised guidance also takes a narrow approach to the types of interest that are included in IFR under the EIFEL rules. Specifically, the CRA states that only interest that is "received or receivable" as interest (or an account of, in lieu of payment, in satisfaction of interest) will be included under paragraph (a) of variable A of the IFR definition. As a result, the CRA advises that, unless an amount is specifically deemed or considered to be interest that is received or receivable, it will not be included in IFR, even if the amount is otherwise treated as "interest-like" income under an anti-avoidance provision or other rules in the Act. For example, amounts included under subsections 12.7(3) or 17(1) would not qualify under paragraph (a) of variable A of the IFR definition.

The CRA's guidance also addresses certain amounts that are specifically excluded from the definition of IFR under subsection 18.2(1), such as certain excluded interest and dividends from credit unions, as well as amounts specifically included in IFR. The CRA notes that paragraph (b) of variable A of the IFR definition targets specific inclusions, such as "accrued" interest under subsection 12(9) and pertinent loan and indebtedness (PLOI) income under subsection 17.1, which are regarded as interest but are not received or receivable.

KPMG observations
At this time, the CRA is still developing guidance to help clarify how to interpret "borrowing or other financing" and "loan or other financing". In the meantime, taxpayers should use a textual, contextual, and purposive approach to analyze and interpret these rules.

Based on the CRA's view regarding embedded financing components, it seems that the CRA may take a more cautious approach to including economic equivalents to interest within the scope of IFR than in IFE for purposes of the EIFEL rules.

In acknowledging that it is taking a narrow interpretation of paragraph (a) of variable A of the IFR definition, the CRA also appears to indicate that certain other debt-related income inclusions (unless specifically enumerated as IFR) may not be within the scope of IFR. Consequently, it would be welcome for the CRA to provide specific examples of which other debt-related income inclusions are or are not included in IFR.

Applying non-capital losses to determine ATI

The CRA has not updated its guidance on applying non-capital losses (NCLs) to determine a taxpayer's ATI to reflect proposed legislative changes to the ATI definition. This proposed legislation amends the mechanics of computing ATI when a taxpayer applies NCLs from other taxation years that would otherwise result in negative taxable income, before the application of the EIFEL rules. These technical changes are proposed in Bill C-15, currently before Parliament, and effective for taxation years ending after August 15, 2025.

KPMG observations
Under the existing EIFEL rules, iterative calculations are required when a prior year's NCL is applied to offset an IFE denial and would otherwise result in negative taxable income and the ATI add-back ratio for that loss is more than zero.

Taxpayers should review their planned application of NCLs for taxation years ending after August 15, 2025 in light of the proposed legislative changes to the ATI definition.

This proposed amendment changes the approach that taxpayers must take for iterative calculations that may arise.

Amalgamations

The CRA has also updated its guidance on corporate amalgamations to incorporate certain EIFEL rules. This guidance is included in Income Tax Folio S4-F7-C1, "Amalgamations of Canadian Corporations". Consistent with EIFEL-related legislative changes, the CRA has updated its guidance to specify that an amalgamated corporation can carry forward and deduct any restricted interest and financing expenses (RIFE) from a predecessor corporation. Additionally, where an amalgamation results in an acquisition of control of the predecessor, the CRA guidance now advises that a predecessor's RIFE will carry over to the amalgamated corporation subject to certain loss restriction rules.

The CRA also clarifies continuity treatment of cumulative unused excess capacity (CUEC) for an amalgamated corporation, including various amounts relevant for computing a taxpayer's CUEC (e.g., absorbed capacity, excess capacity, transferred capacity). Additionally, the CRA notes that, where a taxpayer is subject to an acquisition of control, its CUEC for tax years ending before that time cannot be used by the new corporation or any other taxpayer in a tax year ending after that time.

KPMG observations
While not specifically noted in the Folio, when there is a corporate amalgamation the new corporation will inherit the embedded EIFEL attributes in NCLs for the purposes of computing the new corporation's ATI.

EIFEL elections

Transitional election

The CRA provides new guidance by introducing an example on how groups with a mixed ratio of permissible expenses should determine, report and allocate group net excess capacity (GNEC) for purposes of filing T2224, "Transitional Election Under the Excessive Interest and Financing Expenses Limitation Rules". In the new example, the CRA explains how to determine GNEC when a 40% ratio of permissible expenses applies in the first regime year.

KPMG observations
While many taxpayers' transitional election deadlines have passed, taxpayers may still amend or late file this election in certain circumstances and should be aware of the CRA's illustrative guidance for taxpayers to allocate GNEC for transitional tax years.

Cumulative Unused Excess Capacity transfer election

The CRA's guidance confirms that taxpayers can use a CUEC transfer election to make a jointly filed election with a single transferee or with multiple transferees. In addition, when the transferor and transferee in a CUEC transfer election have different functional currencies, taxpayers should use the transferor's tax reporting currency on Form T2226, "Election to Transfer Cumulative Unused Excess Capacity Under Subsection 18.2(4)".

KPMG observations
The CRA does not include guidance on which exchange rate a taxpayer should use when converting the transferee's received capacity. However, one conversion approach could be to use the spot rate at the end of transferor's taxation year.

Excluded interest election

The CRA guidance also clarifies how to file Form T2227, "Excluded Interest Election Under Subsection 18.2(1)", where the payer and payee have different tax years or functional currencies. The CRA provides a detailed example to address situations where taxpayers' taxation years only partially overlap, to illustrate how the elected amount must be deducted by the payer or included in the payee's income in the correct taxation years for each party.

Additionally, the CRA guidance confirms that, when the payee's tax reporting currency differs from the payer's reporting currency, the payee must convert the excluded interest amounts into its own reporting currency using the relevant spot rate on the day the amount arose. However, the CRA also indicates that the use of an average rate may be accepted in certain circumstances. The CRA also says that it expects the payee to make these conversions throughout the payee's tax year.

Functional currency

The CRA guidance provides new comments on reporting issues related to a taxpayer's functional currency. Specifically, the CRA now clarifies that, when a taxpayer is converting amounts solely for purposes of reporting on an EIFEL election form or SCH130, the taxpayer's inclusions and deductions in computing income, taxable income, and tax payable should not be affected. The CRA confirms that taxpayers must still maintain all financial accounts in the taxpayer's functional currency, as required under section 261.

The CRA also clarifies a reporting issue related to Form T2225, "Group Ratio Rules Election Under Subsection 18.21(2) and Fair Value Adjustments Election Under Subsection 18.21(4)". The CRA notes that, in determining the group ratio for purposes of completing this form, taxpayers should report the various components by using the currency presented in the group's consolidated financial statements.

KPMG observations

Note that the CRA is still developing guidance for situations where Canadian group members that jointly file a Group Ratio Election use different tax reporting currencies, or tax reporting currencies that are different from the currency presented in the group's consolidated financial statements. In the meantime, taxpayers should look to existing laws and CRA administrative positions to determine an appropriate conversion method.

Other compliance updates

Penalties

In its guidance, the CRA states that failure to file form SCH130 with the prescribed information may result in penalties under paragraph 162(7)(b). The general penalty is $25 per day up to 100 days. The minimum penalty is $100 and the maximum penalty is $2,500.

Errors and omissions

The CRA guidance notes that taxpayers who discover errors or omissions after filing SCH130 should re-file the form. The CRA advises that, if this form is not re-filed, the normal reassessment period for EIFEL matters may not start until the form is corrected under paragraph 152(4)(b.8).

Requesting a reassessment

The revised guidance states that, where a taxpayer asks the CRA to reassess a tax return, either to apply a loss to a prior year, correct an error, or include a late-filed election, the taxpayer must file a revised SCH130 with the reassessment request. The CRA notes that this is because such a request may change the taxpayer's taxable income or a NCL and affect EIFEL computations.

Additionally, where a corporation requests a carryback of a loss to a prior year and this results in a change to the computation of excess IFE or eliminates their excluded entity status, the CRA guidance states that the corporation must file a revised SCH1 and an amended or an original SCH130 for the prior year, along with its income tax return. This may be the case even if the taxpayer was not required to file the SCH130 when their prior year's tax return was originally filed.

Schedule 130

The CRA has updated its guidance to clarify other reporting and assessment issues related to the T2SCH130, T3SCH130, T5013SCH130. Specifically, the CRA's revised guidance:

- Clarifies that the T5013SCH130 is only required to be filed if the partnership has IFE or IFR and has non-exempt corporations and trusts as partners

- Discusses how to report amounts for a controlled foreign affiliate (CFA) owned directly by a corporation (which must be reported in Part 2M of T2SCH130) or held through a partnership (which must be reported in Part 2N of T2SCH130), and for a CFA owned directly by a trust (which must be reported in Part 2L of T3SCH130)
- Clarifies that the CRA will not automatically make adjustments where a taxpayer's CUEC elements reported on T2 or T3 SCH130 does not match what was reported in previous years (as a result of an amalgamation, wind-up or loss restriction event)
- Specifies that taxpayers should correct known errors in CUEC calculations from prior years by submitting amended T2SCH130s or T3SCH130s for the affected years.

KPMG observations
The CRA also advises that, in certain situations, it may contact taxpayers for additional clarification or to confirm amounts.

We can help

The EIFEL rules are complex, and your KPMG adviser can help you determine whether you are subject to the new rules and how they may apply to your unique situation, including the tracking of EIFEL attributes and appropriate use of available attributes. For more details on these rules, contact your KPMG adviser.